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FISCAL IMPACT STATEMENT

LS 7906

BILL NUMBER: SB 629

NOTE PREPARED: Jan 16, 2005

BILL AMENDED:

SUBJECT: Enterprise Zone Incentives.

FIRST AUTHOR: Sen. Steele

BILL STATUS: As Introduced

FIRST SPONSOR:

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State

Summary of Legislation: The bill allows Enterprise Zone retail merchants to claim an additional Sales Tax allowance. The bill provides that a taxpayer is entitled to a 30% credit for research expenses incurred in an Enterprise Zone that exceed the taxpayer's research expenses incurred in the Enterprise Zone in 2005. It also provides that the credit may be claimed in addition to the Research Expense Credit for research expenses that are not incurred in an Enterprise Zone. (The introduced version of this bill was prepared by the Enterprise Zone Study Commission.)

Effective Date: July 1, 2005; January 1, 2006.

Explanation of State Expenditures: The DOR would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to incorporate the additional retail merchant's allowance and additional research expense credit for Enterprise Zones. These expenses would be covered under DOR's existing budget and resources.

Explanation of State Revenues: *Retail Merchant's Allowance:* The bill could potentially reduce state Sales Tax revenue by about \$700,000 annually beginning in FY 2006. The amount of the additional retail merchants allowance that could potentially flow to the State Enterprise Zone Board through its Enterprise Zone (EZ) business registration fee is expected to be minimal.

Research Expense Credit: This bill increases the Research Expense Credit for taxpayers located in an enterprise zone for expenses incurred in the EZ from 10% to 30% for tax years beginning January 1, 2006. The incremental revenue loss from increasing the rate of this credit is indeterminable. The revenue loss would

depend on future research activities and income growth of taxpayers making creditable research expenditures in the EZ. The increase in the amount of credits taken would affect revenue collections beginning in FY 2006 (assuming adjustments made to quarterly returns) and years after.

Retail Merchant's Allowance Background: The bill provides for an additional retail merchant's allowance equal to 1% for retail merchants located in an EZ. Under current statute, retail merchants receive a collection allowance equal to 0.83% of the merchant's sales and use tax liability for the monthly reporting period. The revenue loss described above is attributable solely to retail merchants currently operating within EZs. The impact from currently operating retail merchants who may become a part of a new EZ or an expansion of an existing EZ is indeterminable. It is estimated that 1,147 retailers currently operate within Indiana's 28 EZs. The revenue loss estimate is based on this total and the current statewide distribution of retailers relative to the monthly collection allowance they receive.

Under the bill, a retail merchant in an EZ qualifies for the additional 1% allowance provided he or she does all of the following:

- (1) Pays the business registration fee to the State EZ Board required under current statute. This fee is equal to 1% of the annual tax savings accrued by the business from the incentive, if these savings exceed \$1,000 during the year.
- (2) Provides financial assistance to the Urban Enterprise Association (UEA) that administers the EZ as required by current statute. Currently, businesses receiving EZ incentives pay to the UEA a participation fee ranging from 20% to 49% (depending on the EZ) of the annual tax savings from the incentive.
- (3) Complies with any other requirements adopted by the State EZ Board relating to the additional allowance.

The additional 1% allowance is effective for sales transactions occurring after June 30, 2005. Sales Tax revenue is deposited as follows: 49.192% to the state General Fund; 50% to the Property Tax Replacement Fund; 0.635% to the Public Mass Transportation Fund; 0.14% to the Commuter Rail Service Fund; and 0.033% to the Industrial Rail Service Fund.

Research Expense Credit Background: P.L. 242-2002 (ss) increased this credit from 5% to 10% of qualified expenses for tax years beginning January 1, 2003, and eliminated the apportionment factor used to calculate the credit. P.L. 81-2004 made this tax credit permanent. This bill will increase the credit to 30% for taxpayers who are located in an EZ and make qualified research expenses in the EZ with tax years beginning January 1, 2006. This credit would be in addition to the taxpayer's credit for allowable research expenses incurred outside of EZ.

The Research Expense Credit is available for individuals, corporations, limited liability companies, limited liability partnerships, trusts, or partnerships who have increased research activities conducted in Indiana. The credit is calculated based on the increased expenses a taxpayer incurred over their base year expenditures. The bill establishes the base year expenditures in an EZ at those expenses incurred in 2005. A taxpayer is not entitled to a carryback or refund, but may carry forward the tax credit for 15 years.

Preliminary data on the amount of credits claimed statewide after the changes made by P.L. 242-2002(ss) suggest that approximately \$48 M in credits have been *claimed* in the 2003 tax year. This suggests that the base of the potential credits almost doubled over prior levels. (It is unknown how many of these credits were

for investment in an EZ.) However, since there is currently such a large number of suspended returns, DOR is unable to report the level of actual credits *utilized* for tax year 2003, which would indicate the direct and immediate revenue loss from the changes in the rate and base of the credit. A history of the Research Expense Credits taken on the individual and corporate tax returns for the last five years is reported in the table below.

History of Research Expense Credits Utilized				
Tax Year	Tax Rate	Indiv. AGI Credits	Corp. Tax Credits	Total Credits
1999	5%	\$1.6 M	\$25.8 M	\$27.4 M
2000	5%	\$1.6 M	\$18.1 M	\$19.7 M
2001	5%	\$1.2 M	\$21.6 M	\$22.8 M
2002*	5%	\$1.3 M	\$12.3 M *	\$13.6 M *
2003*	10%	\$2.2 M	\$14.0 M *	\$16.2 M *
* 2002 & 2003 tax year estimates are preliminary due to a large number of suspended returns.				

The new credit for EZ taxpayers provides \$300,000 for each \$1M in new research expenses conducted in EZs. Consequently, increased expenditures on research activities could also generate additional Adjusted Gross Income and Sales Tax revenue if these expenses are used to hire additional employees or purchase related equipment. Assuming this economic impact would not have happened absent this incentive, the actual revenue loss from this credit would be mitigated by the incremental increase in other taxes generated by the research activities.

The Research Expense Tax Credit affects revenue collections deposited in the General Fund and the Property Tax Replacement Fund.

Explanation of Local Expenditures:

Explanation of Local Revenues:

State Agencies Affected: Department of State Revenue, Department of Commerce, Enterprise Zone Board.

Local Agencies Affected:

Information Sources: OFMA Enterprise Zone database. Shah Towfighi, Department of State Revenue, 317-232-8022.

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